



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

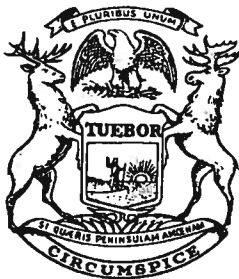
AUDIT REPORT

PERFORMANCE AUDIT
OF

OVERSIGHT OF LOCAL ACCOUNTING SYSTEM
REPLACEMENT (LASR) PAYMENT PROCESSING

DIVISION OF FINANCIAL MANAGEMENT
BUREAU OF ACCOUNTING
DEPARTMENT OF HUMAN SERVICES

August 2011



THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

– Article IV, Section 53 of the Michigan Constitution

Audit report information can be accessed at:
<http://audgen.michigan.gov>



Michigan
Office of the Auditor General
REPORT SUMMARY

Performance Audit

**Oversight of Local Accounting System
Replacement (LASR) Payment Processing**
Division of Financial Management, Bureau of
Accounting, Department of Human Services

Report Number:
431-0450-10

Released:
August 2011

Local Accounting System Replacement (LASR) is a customized commercial accounting application used by Department of Human Services (DHS) local offices to record transactions processed at the local offices using county funds. Generally, the transactions are initially paid from a county's Social Welfare Fund or Child Care Fund and subsequently reimbursed by the State.

Audit Objective:

To assess the effectiveness of the Division of Financial Management's efforts to ensure appropriate user access to LASR.

Audit Conclusion:

We concluded that the Division's efforts to ensure appropriate user access to LASR were not effective. We noted one material condition (Finding 1) and one reportable condition (Finding 2).

Material Condition:

The Division had not established effective internal control for granting and monitoring access to LASR (Finding 1).

Reportable Condition:

The Division did not limit assigning incompatible responsibilities to LASR users. Also, the Division had not developed a process to identify and to assess for reasonableness DHS local

offices' compensating controls prior to assigning incompatible responsibilities to users. (Finding 2)

~ ~ ~ ~ ~

Audit Objective:

To assess the effectiveness of the Division's efforts to monitor local offices' use of LASR to process payments.

Audit Conclusion:

We concluded that the Division's efforts to monitor local offices' use of LASR to process payments were moderately effective. We noted one material condition (Finding 3) and four reportable conditions (Findings 4 through 7).

Material Condition:

DHS did not determine the entity responsible for federal Internal Revenue Service (IRS) 1099 reporting for LASR payments processed by DHS local offices (Finding 3).

Reportable Conditions:

The Division had not established sufficient guidance and appropriate oversight for vehicle purchase transactions processed through LASR (Finding 4).

The Division had not developed a process to periodically monitor LASR transactions on a Statewide basis (Finding 5).

DHS did not ensure that LASR on-site oversight was timely and complete (Finding 6).

The Division's processes for verifying LASR payee information were inadequate (Finding 7).

~ ~ ~ ~ ~

Agency Response:

Our audit report contains 7 findings and 8 corresponding recommendations. DHS's preliminary response indicated that it agrees with all of the recommendations.

~ ~ ~ ~ ~

A copy of the full report can be
obtained by calling 517.334.8050
or by visiting our Web site at:
<http://audgen.michigan.gov>



Michigan Office of the Auditor General
201 N. Washington Square
Lansing, Michigan 48913

Thomas H. McTavish, C.P.A.
Auditor General

Scott M. Strong, C.P.A., C.I.A.
Deputy Auditor General



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

August 16, 2011

Ms. Maura D. Corrigan, Director
Department of Human Services
Grand Tower
Lansing, Michigan

Dear Ms. Corrigan:

This is our report on the performance audit of Oversight of Local Accounting System Replacement (LASR) Payment Processing, Division of Financial Management, Bureau of Accounting, Department of Human Services.

This report contains our report summary; description; audit objectives, scope, and methodology and agency responses; comments, findings, recommendations, and agency preliminary responses; two exhibits, presented as supplemental information; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a plan to address the audit recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

We appreciate the courtesy and cooperation extended to us during the audit.

AUDITOR GENERAL

SUPPLEMENTAL INFORMATION

Exhibit 1 - Details Regarding Vehicle Purchase Price	34
Exhibit 2 - Details Regarding Selected LASR Transactions With DHS Employees	35

GLOSSARY

Glossary of Acronyms and Terms	39
--------------------------------	----

Description

Local Accounting System Replacement* (LASR) is a customized commercial accounting application used by Department of Human Services (DHS) local offices to record local office financial transactions. Generally, these transactions are initially funded by a county and DHS later reimburses the county treasurer using the Michigan Administrative Information Network* (MAIN). A county's Social Welfare Fund is used to account for the operations of the DHS local office to administer public welfare programs that are primarily supported by the State and federal government. A county's Child Care Fund is a cost-sharing program between a county and the State for the care and treatment of neglected, abused, and delinquent children.

DHS annually authorizes funding for its local offices for certain program payments for client, volunteer, and administrative services provided through its local offices. Section 400.73a and Section 400.117c of the *Michigan Compiled Laws* designate the county treasurer as the custodian of the monies within the county's Social Welfare Fund and Child Care Fund, respectively. The DHS Division of Financial Management has administrative responsibility for LASR.

DHS maintains a local office accounting manual that includes procedures regarding LASR usage; however, each local office establishes business procedures that may be different from these prescribed procedures. LASR contains some automated edits; however, the business procedures at a local office provide significant internal control* for LASR transaction processing.

The Local Office Liaison Unit (LOL) within the Division performs the primary LASR monitoring function. LOL is responsible for day-to-day oversight and support to local offices. Three LOL regional accountants also perform periodic on-site fiscal reviews of the local offices' use of LASR. Other DHS organizational areas that provided some LASR oversight during our audit period included the Bureau of Juvenile Justice and the Federal Compliance Division, which conducted reviews of certain Child Care Fund payments, and the Office of Internal Audit, which performed audits of local offices on a

* See glossary at end of report for definition.

rotating cycle of approximately every five years. Effective October 1, 2007, Executive Order No. 2007-31 transferred the Office of Internal Audit within DHS to the Director of the State Budget Office within the Department of Technology, Management & Budget (DTMB). DTMB also provided technical support, including providing user* access to LASR.

For the 12-month period May 1, 2009 through April 30, 2010, DHS local offices processed payments of \$52 million through LASR with Social Welfare Fund and Child Care Fund payments totaling \$28 million and \$24 million, respectively.

** See glossary at end of report for definition.*

Audit Objectives, Scope, and Methodology and Agency Responses

Audit Objectives

Our performance audit* of Oversight of Local Accounting System Replacement (LASR) Payment Processing, Division of Financial Management, Bureau of Accounting, Department of Human Services (DHS), had the following objectives:

1. To assess the effectiveness* of the Division's efforts to ensure appropriate user access to LASR.
2. To assess the effectiveness of the Division's efforts to monitor local offices' use of LASR to process payments.

Audit Scope

Our audit scope was to examine the records and procedures related to oversight of the Local Accounting System Replacement application to process payments. We reviewed user access to the Local Accounting System Replacement application. Our scope did not include an assessment of the Michigan State Disbursement Unit's use of LASR related to the State's centralized child support collection process. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Audit Methodology

Our audit procedures, performed in January and February 2006, April 2006 through November 2006, and May 2010 through September 2010, included an examination of records primarily for the periods October 2004 through July 2006 and May 2008 through August 2010.

We conducted a preliminary review to gain an understanding of DHS's activities to form a basis for defining our audit scope and for selecting certain operations for audit. Our preliminary review included interviewing DHS and Department of Technology,

* See glossary at end of report for definition.

Management & Budget (DTMB) personnel, reviewing applicable legislation and rules related to a county's Social Welfare Fund and Child Care Fund, and reviewing policies and procedures to gain an understanding of local offices' use of LASR and DHS's county reimbursement processes. We obtained an understanding of the LASR application, analyzed available LASR data, and reviewed material related to management oversight of LASR.

To accomplish our first objective, we met with DHS and DTMB staff and determined procedures for granting access to LASR. We reviewed the State's information technology policy and procedures for information technology access control*. We tested LASR user access by selecting and testing a sample of user access authorization forms to ensure that access had been authorized and provided as requested. We also tested the employment status and work location of individuals identified as current LASR users. We reviewed LASR user responsibilities* to identify those that would be incompatible to ensure a separation of duties for staff and analyzed the appropriateness of responsibilities that had been provided to LASR users. We analyzed transaction detail recorded in LASR to determine whether the users had performed incompatible duties when processing transactions.

To accomplish our second objective, we met with DHS staff to discuss LASR oversight and reviewed guidance for on-site monitoring at local offices performed by various units at DHS. We analyzed the on-site monitoring performed by the Division's Local Office Liaison Unit (LOL) staff and reviewed LOL travel budgets. We performed various analytical procedures of LASR data for reasonableness and completeness. We tested local office compliance with LASR requirements by selecting and reviewing 110 LASR transactions.

When selecting activities or programs for audit, we use an approach based on assessment of risk and opportunity for improvement. Accordingly, we focus our audit efforts on activities or programs have the greatest probability for needing improvement as identified through a preliminary review. Our limited audit resources are used, by design, to identify where and how improvements can be made. Consequently, we prepare our performance audit reports on an exception basis.

** See glossary at end of report for definition.*

Agency Responses

Our audit report contains 7 findings and 8 corresponding recommendations. DHS's preliminary response indicated that it agrees with all of the recommendations.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100) require DHS to develop a plan to address the audit recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

COMMENTS, FINDINGS, RECOMMENDATIONS,
AND AGENCY PRELIMINARY RESPONSES

EFFECTIVENESS OF EFFORTS TO ENSURE APPROPRIATE USER ACCESS TO LASR

COMMENT

Audit Objective: To assess the effectiveness of the Division of Financial Management's efforts to ensure appropriate user access to Local Accounting System Replacement (LASR).

Audit Conclusion: We concluded that the Division's efforts to ensure appropriate user access to LASR were not effective. Our audit disclosed one material condition*. The Division had not established effective internal control for granting and monitoring access to LASR (Finding 1).

Our audit also disclosed a reportable condition* related to LASR users' incompatible responsibilities (Finding 2).

FINDING

1. LASR User Access

The Division had not established effective internal control for granting and monitoring access to LASR. Establishing effective internal control would help ensure that only appropriate transactions are processed in LASR.

Control Objectives for Information and Related Technology (COBIT) states that effective system security requires management to implement procedures to provide access based on the level of user need, to ensure timely action relating to establishing and closing user accounts, and to periodically monitor to ensure that access rights correspond to the users' and organization's needs. Department of Technology, Management & Budget (DTMB) Administrative Guide policy 1335.00 and procedure 1350.20 assign to State agencies, as the data owners, the responsibility to authorize appropriate user access, to periodically evaluate user privileges, and to promptly request termination of privileges within 48 hours of a change in the user's employment with the agency or State government.

The LASR security administrator, within the Department of Human Services (DHS) Application Security, provided access to LASR users based on a LASR security

* See glossary at end of report for definition.

access request for local/central office users (DHS-84) form that was completed by the employee and the employee's supervisor. The DHS-84 form listed the available LASR responsibilities that could be granted and the employee's supervisor indicated the requested access by marking a box next to the responsibility. When completed, the DHS-84 form was forwarded directly to the LASR security administrator.

In 2007, the Division established procedures for its staff to review the forms for reasonableness before the LASR security administrator provides access. However, the Division did not establish procedures for ongoing monitoring of current employees' access privileges or procedures to ensure that access is removed for departed employees.

Our review of LASR user access and system privileges disclosed:

- a. The Division did not ensure that only authorized employees had access to LASR.

Thirteen (4%) of LASR's 325 total users either were not current employees or were on an indefinite leave of absence as of May 2006. For 6 (46%) of the 13, their LASR user identification had been used to access LASR after they had retired from DHS, left to work at another State agency, or were on a leave of absence. We noted that DHS removed LASR access for 12 (92%) of the 13 users, and the thirteenth user returned from a leave of absence.

Subsequently, our May 2010 analysis noted that 7 (3%) of LASR's 268 total users were not current employees. For 2 (29%) of the 7, their LASR user identification had been used to access LASR after they had retired from DHS or left employment with DHS. After our May 2010 analysis, DHS deactivated LASR access for these 7 LASR users.

DHS had no assurance that either departed employees or unauthorized employees had not accessed LASR to process transactions.

- b. The Division did not monitor LASR user access and system privileges. We noted:

- (1) Twenty (6%) of 316 DHS employees who were current authorized LASR users as of May 2006 had access to LASR data at a different DHS local office than the DHS local office to which they were assigned, and they had not obtained approval from the Division for this access. DHS notified local offices of a LASR security review of user access in L-Letter 04-105, dated September 9, 2004. The LASR security review was to ensure that DHS-84 forms were in place for each user and to correct staff user responsibilities. Exception requests stating the business need for staff at one DHS local office to have access at another DHS local office were to be approved by the Division.

Prior to our August 2010 analysis, DHS had taken no corrective action regarding the 20 employees cited in the preceding paragraph. Eleven (55%) of the 20 DHS employees maintained access to LASR data at a different DHS local office than the DHS local office to which they were assigned. Subsequent to our follow-up review, DHS local offices submitted exception requests for 8 (73%) of the 11 employees. DHS deactivated access to LASR data at the unassigned DHS local office for 2 (18%) of the 11 employees and deactivated LASR access at all DHS local offices for 1 (9%) of the 11 employees.

A subsequent analysis in August 2010 noted 6 additional DHS employees who had LASR access at multiple local offices without obtaining approval from the Division for access. After our subsequent analysis, DHS local offices submitted exception requests for these employees.

- (2) Four central office staff had inappropriately been assigned the high level Local Office Liaison Unit (LOL) User responsibility as of June 2006. DHS was not aware that this responsibility had been assigned to these staff until we brought it to its attention. The LOL User responsibility permits the user to perform all LASR functions at the DHS local office, such as creating invoices and generating payments.

A subsequent analysis in June 2010 noted that 3 (75%) of the 4 central office staff continued to have the inappropriately assigned high level LOL User responsibility. After our subsequent analysis, DHS removed the high level LOL User responsibility for the 3 central office staff in question.

- (3) Three DTMB LASR system administrators* as of June 2006 had the Security Enroll responsibility that permits enrolling application users. These 3 were in addition to the 2 DTMB employees designated as the primary and backup LASR security administrators assigned this function. Such privileged access* is high risk and should be monitored by management.

A subsequent analysis in June 2010 noted that 1 (33%) of the 3 DTMB LASR system administrators still had the Security Enroll responsibility that permits enrolling application users. After our subsequent analysis, DHS removed the Security Enroll responsibility for the DTMB staff member in question.

- (4) Forty-eight (98%) of 49 users on the LASR user inactivity report (LR-830) dated May 10, 2006 had not logged on to the system for more than one year, and 2 (4%) of the 48 users had not logged on to the system since 1999. These employees may no longer need access to the system to perform their duties. Allowing employees to maintain access to LASR creates unnecessary opportunity for inappropriate transactions. Also, because there is an annual licensing fee for each LASR user, removing access to LASR when it is no longer needed would result in financial savings.

A subsequent analysis noted that all 26 users on the LASR user inactivity report (LR-830) dated May 21, 2010 had not logged on to the system for more than one year and that 1 (4%) of the 26 users had not logged on to the system in over three years.

** See glossary at end of report for definition.*

RECOMMENDATION

We recommend that the Division establish effective internal control for granting and monitoring access to LASR.

AGENCY PRELIMINARY RESPONSE

DHS agrees. DHS informed us that procedures to ensure that only authorized users have access to LASR will be implemented by September 1, 2011.

FINDING

2. LASR Users' Incompatible Responsibilities

The Division did not limit assigning incompatible responsibilities to LASR users. Also, the Division had not developed a process to identify and assess for reasonableness DHS local offices' compensating controls prior to assigning incompatible responsibilities to users. As a result, the Division did not limit the ability of LASR users to create and process improper transactions.

DTMB Administrative Guide policy 1335.00 states that when an agency grants access to its systems, it is to ensure that it promotes separation of duties and provides the least privileges necessary. In addition, DHS Accounting Manual item 400 states that local offices' procedures for processing LASR transactions are to ensure the basic internal control principle of separation of duties between the creation and processing of financial transactions. If local office staffing limits do not allow for strict adherence to the suggested procedures, compensating controls are required to maintain an adequate internal control environment.

Our review disclosed that Division staff did not review the DHS-84 forms for incompatible responsibilities, did not require local offices to justify the reason for requesting incompatible responsibilities, and did not require local offices to identify the compensating controls they had established to mitigate the risk associated with staff having LASR incompatible responsibilities.

We reviewed the LASR responsibilities granted for active users as of June 7, 2006. We noted that 227 (73%) of 309 active LASR users had incompatible responsibilities, such as the ability to both create and process an invoice for payment on LASR.

We also analyzed LASR payments for fiscal year 2005-06 (through July) to identify staff that were processing payments in the system. We noted that for 74% of the payments analyzed, LASR records indicated that the same user created the invoice, processed the invoice for payment, and then approved the check to make the payment. However, the Division had not determined the local offices' compensating controls for users with incompatible duties processing LASR payments.

An internal audit report issued in July 2009 noted continued concerns regarding LASR users' incompatible responsibilities. DHS informed us that it had established a work group to address the findings noted in the audit.

RECOMMENDATIONS

We recommend that the Division limit assigning incompatible responsibilities to LASR users.

We also recommend that the Division develop a process to identify and assess for reasonableness DHS local offices' compensating controls prior to assigning incompatible responsibilities to users.

AGENCY PRELIMINARY RESPONSE

DHS agrees. DHS informed us that it has drafted a comprehensive document that identifies the LASR roles and responsibilities to aid the local office when requesting user access. DHS indicated that it will develop a procedure to review compensating controls for incompatible responsibilities. The guide and procedure will be available to the local offices by September 1, 2011.

EFFECTIVENESS OF EFFORTS TO MONITOR LOCAL OFFICES' USE OF LASR TO PROCESS PAYMENTS

COMMENT

Audit Objective: To assess the effectiveness of the Division's efforts to monitor local offices' use of LASR to process payments.

Audit Conclusion: We concluded that the Division's efforts to monitor local offices' use of LASR to process payments were moderately effective. Our audit disclosed one material condition. DHS did not determine the entity responsible for federal Internal Revenue Service (IRS) 1099 reporting for LASR payments processed by DHS local offices (Finding 3).

Our audit also disclosed four reportable conditions related to vehicle purchases for DHS clients, LASR transaction monitoring, LASR on-site oversight, and verification of LASR payee information (Findings 4 through 7).

FINDING

3. IRS 1099 Reporting Process

DHS did not determine the entity responsible for federal IRS 1099 reporting for LASR payments processed by DHS local offices. As a result, DHS may not be in compliance with IRS requirements and may be subject to penalties from the federal government.

IRS regulations require an entity to issue an IRS 1099 statement to a payee whenever the entity has made cumulative payments of \$600 or more annually for certain services, such as rents or medical and health care payments. The IRS regulations also state that if the entity cannot show reasonable cause for its failure to issue the statements, a penalty of \$50 per payee statement and an annual maximum of \$100,000 can be imposed. Intentional disregard of the requirement results in a penalty of at least \$100 per payee statement with no annual maximum penalty limit.

DHS annually authorized funding for its local offices to provide services to its clients through its local offices. The DHS local offices paid for these services by issuing LASR payments against county accounts. The county treasurers maintained funds for these services within their counties' Social Welfare Fund and Child Care Fund as authorized in Section 400.73a and Section 400.117c, respectively, of the *Michigan Compiled Laws*. DHS later reimbursed the county treasurers for these LASR payments using the State's accounting system, the Michigan Administrative Information Network (MAIN).

We reviewed LASR payment data and vendor information in MAIN and determined that DHS did not issue, or cause to be issued, IRS 1099 statements for the following:

IRS 1099 Statements Not Issued

<u>Review Period</u>	<u>LASR Payments</u>	<u>LASR Payees</u>
October 1, 2004 through September 30, 2005	\$1.4 million	198
May 1, 2009 through April 30, 2010	\$5.5 million	1,047

These payees also received payments through MAIN that the State identified as IRS 1099 reportable in the State master vendor file. The LASR payments are likely IRS 1099 reportable income to the payees, with one payee receiving payments totaling approximately \$126,000 from October 1, 2004 through September 30, 2005 and six payees receiving payments in excess of \$100,000 each (ranging from \$100,193 to \$131,646) from May 1, 2009 through April 30, 2010.

Further, DHS did not issue, or cause to be issued, IRS 1099 statements for an additional \$3.8 million of LASR payments from October 1, 2004 through September 30, 2005 made to 1,058 LASR payees and an additional \$3.5 million of LASR payments from May 1, 2009 through April 30, 2010 made to 1,863 LASR payees that may have had IRS 1099 reportable income. Although LASR identified these 2,921 payees as vendors on the LASR files, they did not appear in the State master vendor file because they did not receive payments through MAIN. Consequently, we could not determine if this was likely IRS 1099 reportable income to these payees.

In addition, DHS could not provide confirmation that county treasurers had issued the required IRS 1099 statements for any LASR payments.

Our analysis focused on current IRS 1099 reporting requirements that include the provision of services by payees. However, the Patient Protection and Affordable Care Act contains expanded IRS 1099 reporting requirements that include goods as well as services and the reporting of payments to additional entity types not previously reported, including corporations. The expanded IRS 1099

reporting requirements are effective for payments issued on or after January 1, 2012. DHS will need to evaluate LASR for changes needed to support the expanded IRS 1099 reporting requirements.

RECOMMENDATION

We recommend that DHS determine the entity responsible for federal IRS 1099 reporting for LASR payments processed by DHS local offices.

AGENCY PRELIMINARY RESPONSE

DHS agrees. DHS informed us that it established a process to issue 1099s for the 2010 tax reporting calendar.

FINDING

4. Vehicle Purchases for DHS Clients

The Division had not established sufficient guidance and appropriate oversight for vehicle purchase transactions processed through LASR. Such a process would help the Division ensure that LASR vehicle purchase transactions are adequately documented and justified and protect the best interests of DHS and its clients served.

During our review:

- a. We examined 110 LASR transactions involving DHS employees for the period October 1, 2004 through July 31, 2006 and identified 7 transactions in which local office staff purchased vehicles on behalf of a DHS client. For all 7 (100%) of the vehicle purchases for clients, local office staff did not adequately document compliance with DHS policies. Also, DHS policies did not require sufficient detail to document the reasonableness and propriety of vehicle purchases. In 6 (86%) of the 7 transactions, a DHS employee was the vehicle seller (employee/client transaction) and for 1 (14%) transaction, a contracted agency purchased the vehicle for the client. We noted:

- (1) Four (67%) of the 6 employee/client transactions lacked the required vehicle inspection report.

DHS Program Eligibility Manual (PEM) item 232 requires a vehicle inspection by a licensed mechanic.

- (2) All 6 employee/client transactions lacked support that DHS had determined that no conflict of interest existed for the transaction. For 2 (33%) of the 6 transactions, we concluded that a family relationship existed between the DHS employee seller and the client based on our review of Department of State vehicle transfer records.

DHS Administrative Handbook Personnel & Professional Development (AHP) item 602 requires a DHS employee to disclose to his/her immediate supervisor the details of a sales transaction with a DHS client. The supervisor is to discuss the details with the proper administration to determine whether a conflict of interest exists.

- (3) Two (33%) of the 6 employee/client transactions lacked support for the reasonableness of the vehicle purchase price (see Exhibit 1, presented as supplemental information).

DHS PEM item 232 requires that the cost of the vehicle not exceed the vehicle's retail value. The policy allows a written statement from, or a telephone call to, a vehicle dealer or the National Automobile Dealers Association Appraisal Guide as acceptable verification of the vehicle's retail value.

- (4) For 1 transaction, a DHS local office reimbursed a contracted agency for a vehicle's purchase cost of \$2,812 and repair costs of \$1,814.

DHS PEM item 232 limited client vehicle purchases to a lifetime limit of \$1,200 and a repair limit of \$900 at the time of this transaction.

- (5) DHS AHP item 602 requires that a DHS employee disclose to his/her immediate supervisor the details of a sales transaction with a DHS client. It further states that the supervisor will discuss the details with the proper administration. However, the policy did not address how the supervisor should report the potential conflict, the appropriate DHS administration to

make the determination of whether a conflict of interest exists, how the final determination is to be documented, and a requirement for a statement signed by the employee attesting that no conflict exists.

- (6) DHS PEM item 232 requires a vehicle inspection by a licensed mechanic and states that the cost of the vehicle or repairs is not to exceed the vehicle's retail value. However, the policy lacked guidance on a reasonable time limit between the inspection and sale to the client or a requirement that the inspection report include a determination of the overall condition of the vehicle. The National Automobile Dealers Association Appraisal Guide indicates that a vehicle's retail value is based on the vehicle's condition. There are questionable benefits to both the client and DHS when DHS purchases older vehicles with extensive mileage and limited utility.
- b. We identified all vehicle purchase transactions charged against the Direct Support Services, State Administrative, and Youth in Transition Programs from May 1, 2008 through April 30, 2010 because of the high concentration of vehicle purchase transactions charged to these programs.

DHS local office staff used LASR to purchase 2,496 vehicles and repair 8,808 vehicles at a cost of \$3.5 million and \$5.7 million, respectively (primarily for the Direct Support Services Program). Of the 2,496 vehicles purchased using LASR, 68% were purchased for the maximum amount allowed by policy at the time of purchase.

Our analytical review of LASR transactions within these three programs during our review period disclosed that DHS local offices purchased 2,496 vehicles using LASR that resulted in only 194 (8%) payments for vehicle inspections using LASR during the same time frame. DHS Bridges Eligibility Manual (BEM) item 232 requires a vehicle inspection by a licensed mechanic for all vehicle purchases.

We did not expect to see individual vehicle inspection payments in LASR for every vehicle purchased. However, the lack of supporting documentation for vehicle inspections noted during our employee transaction analysis and the

extremely low rate of vehicle inspection payments noted in LASR indicate a continued lack of vehicle inspections.

RECOMMENDATION

We recommend that the Division establish sufficient guidance and appropriate oversight for vehicle purchase transactions processed through LASR.

AGENCY PRELIMINARY RESPONSE

DHS agrees. DHS informed us that policy changes and additional guidance will be in place by January 2012. DHS indicated that it will implement a risk-based approach for reviewing transactions by October 1, 2011.

FINDING

5. LASR Transaction Monitoring

The Division had not developed a process to periodically monitor LASR transactions on a Statewide basis. Consequently, the Division is unable to effectively and efficiently identify areas of risk, determine instances when DHS local office staff may not have followed acceptable LASR practices, and provide a mechanism for LOL staff to prioritize on-site local office fiscal reviews.

LASR is not set up to provide information on a Statewide basis. As a part of our audit, DTMB developed queries for our analysis of LASR transactions. Our review of this information identified the following types of expenditures that would warrant central office review:

- a. The Division did not scrutinize LASR transactions that reimbursed local office employees for goods purchased or services provided. We identified 2,535 payments totaling \$426,128 that were made to DHS employees for the period October 1, 2004 through July 31, 2006. These payments were primarily for the replacement of payroll warrants, payments for the purchase of vehicles for DHS clients when the DHS employee was the vehicle seller, employee travel reimbursement, and reimbursement to employees for equipment purchases (see Exhibit 2, presented as supplemental information).

Also, we performed risk-based analytical procedures of LASR transactions for the period May 1, 2008 through April 30, 2010 and identified payments made to DHS employees totaling \$702,326. This represents an increase of 51% when compared with our initial review prorated over a similar 22-month period.

- b. The Division did not identify high-risk LASR transactions and DHS local office trends warranting further analysis and justification.

We conducted additional analytical procedures for transactions charged against the Direct Support Services, State Administrative, and Youth in Transition Programs because of the concentration of high-risk transactions, which included vehicle purchases and repairs (see Finding 4), computer purchases, and other portable equipment purchases. We noted that DHS local office staff used LASR to purchase 356 computers at a cost of approximately \$232,000 (primarily for the Youth in Transition Program).

Our analytical review of LASR transactions within these three programs during our review period disclosed:

- (1) ^{99.00} One DHS local office purchased 28 personal digital assistants (PDAs) for \$2,772 in May 2008 and 47 iPods for \$4,202 in May 2009 as graduation gifts for participants in the Youth in Transition Program.
- (2) Some DHS local offices used LASR to purchase \$470,340 in gas and gift cards for use in the Direct Support Services Program. This appears to be a violation of DHS procedure which prohibits the use of Direct Support Services Program funding for "gift or gas cards that are not restricted to specific purchases or services." In our further review of these transactions, we noted:
 - (a) In July 2008, one DHS local office processed a transaction using LASR paid to Speedway Super America LLC for \$19,998 with an invoice description entitled "prepaid card B1069." It is unclear whether this transaction was for one or multiple gift cards.

- (b) For the 12-month period May 1, 2009 through April 30, 2010, DHS local offices used LASR to purchase \$240,412 in gas and gift cards. Specifically, DHS local offices used LASR to purchase \$129,571 (54%) in gas and gift cards during the month of September, immediately prior to the close of the State's accounting records on September 30. Also, one DHS local office accounted for 43% of the gas and gift cards purchased during this same 12-month period, including the purchase of 55 Walmart \$500 gift cards in one day. The same DHS local office used LASR to purchase only \$15,996 in gas and gift cards during the previous 12-month period, including only 5 \$500 gift cards.
- (c) One DHS local office purchased 4 gift cards in \$1,000 denominations (for Target and Walmart) for bulk supplies.

The use of gas and gift cards, especially in large denominations, reduces the control over valuable State assets and increases the risk of loss or inappropriate use by both DHS clients and DHS local office staff.

Also, because of departmental reorganizations and staffing limitations noted in Finding 6, the ability of DHS to ensure appropriate LASR expenditures has been reduced. The use of analytical processes on a Statewide basis would provide for an effective and efficient process to help ensure the appropriate local office use of LASR and prioritize limited LOL resources to local offices in need of guidance.

RECOMMENDATION

We recommend that the Division develop a process to periodically monitor LASR transactions on a Statewide basis.

AGENCY PRELIMINARY RESPONSE

DHS agrees. DHS informed us that policy changes and additional guidance will be in place by January 2012. DHS indicated that it will implement a risk-based approach for reviewing transactions and performing site visits of local offices. This will be in place by October 1, 2011.

FINDING

6. LASR On-Site Oversight

DHS did not ensure that LASR on-site oversight was timely and complete. As a result, DHS could not ensure that local office employees complied with requirements when processing payments through LASR and could not ensure the validity of LASR payees.

Section 400.73a of the *Michigan Compiled Laws* provides DHS the authority for Social Welfare Fund accounting, including the authority to establish procedures and controls with respect to all Social Welfare Fund financial transactions, including payments. It also allows DHS to prescribe the manner and extent of documentation related to payments. *Michigan Administrative Code* R 400.2031 provides that all expenditures from a DHS local office Child Care Fund account are to be in accordance with DHS's accounting and administrative manuals and are to be available for audit.

We identified the following DHS organizational units with assigned oversight duties during our audit period related to LASR payments:

- LOL performed the primary LASR monitoring function and provided certain day-to-day LASR oversight. Three regional accountants within LOL also performed periodic on-site fiscal reviews of the DHS local offices' use of LASR. The goal of an LOL on-site fiscal review includes determining whether a DHS local office's internal control is adequate, whether local office accounting records are accurate, and whether local office financial transactions, including payments, are processed in compliance with the DHS Accounting Manual.
- The DHS Bureau of Juvenile Justice and later the Federal Compliance Division conducted on-site reviews that included fiscal reviews of certain LASR payments made by DHS local offices and disbursed from the Child Care Fund.
- The Office of Internal Audit performed local office audits on an approximately five-year rotating cycle. These audits included a review of LASR security controls and controlled documents, such as LASR blank checks and purchase orders or invoices.

Our review of DHS oversight activities disclosed:

- a. LOL had not established a formal policy for the frequency of on-site fiscal reviews at local offices or a process to ensure that all local offices had been reviewed according to an established cycle.

LOL staff informed us that there is an informal policy for a desired annual local office on-site fiscal review, but a minimum of a biennial review is acceptable. However, we determined that 16 (32%) of 50 local offices that processed LASR payments had not had an on-site fiscal review within the 24-month period ended August 15, 2006 and 12 of the 16 had not had an on-site fiscal review for a period of almost three years.

Since our initial analysis, LOL has steadily improved its completion of on-site fiscal reviews. The following chart summarizes completed on-site fiscal reviews over the last four fiscal years:

Fiscal Year	Reviews Completed (of 38 Offices)
2006-07	14 (37%)
2007-08	22 (58%)
2008-09	26 (68%)
2009-10 (through June 30, 2010)	28 (74%)

However, LOL has never conducted an on-site fiscal review of the Wayne County and Wexford Region 2 local offices. For the 12-month period ended April 30, 2010, the Wayne County local office processed \$5.9 million (11%) and the Wexford Region 2 local office processed \$1.3 million (3%) in total LASR transactions for the same period.

Establishing a formal policy of the frequency for LOL regional accountants to perform on-site fiscal reviews and identifying reasonable criteria to prioritize adjustments to the cycle, including prior fiscal review results and analytical reviews of LASR transactions, would assist LOL in its efforts to monitor local offices' use of LASR.

b. LOL's on-site fiscal review transaction analysis was limited in scope and not adequately documented. We noted:

(1) LOL limited its review of LASR transactions to the most recently completed one-month period. In some cases, particularly at larger local offices, LOL reviewed as little as one week of LASR transactions. As a result, the vast majority of LASR transactions were not subject to review by LOL.

(2) LOL did not document its review of LASR transactions during local office on-site fiscal reviews. We reviewed 13 LOL on-site fiscal review files and found no documentation to support the individual transactions reviewed, the criteria for which they were reviewed, and the results of the review.

c. DHS did not ensure that it monitored all payment types recorded in LASR.

LOL review procedures included only Social Welfare Fund transactions. However, for the May 1, 2009 through April 30, 2010 12-month period, LASR Child Care Fund payments totaled \$24.1 million and represented 47% of LASR payments. LOL staff informed us that they do not believe that they have the authority to review local office Child Care Fund LASR payments and stated that the Bureau of Juvenile Justice, the Federal Compliance Division, and the Office of Internal Audit have authority and responsibility for reviewing these payments.

However, we determined that the Bureau of Juvenile Justice limited its review of local office Child Care Fund LASR payments to strictly those for the in-home care program. In-home care program payments accounted for a small portion of Child Care Fund payments processed through LASR. More recently, the Federal Compliance Division local office annual reviews limit the review of Child Care Fund LASR payments to the most recently completed four-month period. Also, LOL does not coordinate with the Federal Compliance Division regarding the procedures used to review Child Care Fund LASR payments or the results of these reviews.

In addition, Executive Order No. 2007-31, effective October 1, 2007, transferred DHS's Office of Internal Audit to DTMB's Office of Internal Audit Services within the State Budget Office as part of the Statewide internal audit consolidation. The Office of Internal Audit Services informed us that its role does not include performing routine monitoring activities for DHS. Consequently, DHS had no assurance that local offices had properly documented, reviewed, and approved all Child Care Fund payments.

RECOMMENDATION

We recommend that DHS ensure that LASR on-site oversight is timely and complete.

AGENCY PRELIMINARY RESPONSE

DHS agrees. DHS informed us that it will implement a risk-based approach for reviewing transactions and performing site visits of local offices. This will be in place by October 1, 2011.

FINDING

7. Verification of LASR Payee Information

The Division's processes for verifying LASR payee information were inadequate. Because of the extensive incompatible responsibilities granted to local office LASR users, the lack of an adequate process to verify new LASR payees or changes to payee information increases the risk of inappropriate LASR payments.

Our review disclosed:

- a. LOL did not verify the accuracy of payee information for payees who had not previously registered in either MAIN or the DHS Client Information Management System (CIMS).

We identified 22 (9%) of 246 new payees entered into LASR over a two-day sample period who did not appear in either MAIN or CIMS. From August 2008 through August 2009, DHS phased-in its new Bridges Integrated Automated

Eligibility Determination System (Bridges) that replaced CIMS and other DHS systems. In Bridges, we identified 13 (7%) of 188 new payees entered into LASR over a three-day sample period who did not appear in either MAIN or Bridges.

Local offices used an interface process to establish new payees in LASR who had previously registered as a vendor in MAIN or who appeared in CIMS or Bridges. If new payees were not already in those systems, local offices established the payee directly in LASR without verification of the accuracy of the information or existence of the payee (employer identification number verification, address search, etc.). Because LOL had not developed a method to verify payee information for these instances, an increased risk existed that local offices could establish fraudulent or fictitious payees in LASR.

- b. LOL's processes implemented to monitor changes made to payee information did not function adequately. Lack of monitoring of changes to payee information increases the risk that LASR payments could be inadvertently or deliberately diverted to an incorrect payee.

LOL relied upon a LASR system-generated e-mail alert of changes to monitor and review the propriety of changes to payee information. We determined that LASR did not generate an e-mail alert for all types of information changes. For a two-day sample period, we determined that LOL did not receive payee information change alerts for 26 (43%) of 60 applicable changes. After DHS phased-in Bridges, a one-day sample period noted that LOL did not receive payee information change alerts for 105 (71%) of 148 applicable changes.

In response to a prior audit finding, DHS created a new/modified supplier report (LR-095 report). The LR-095 report has three components: the "New" component lists all new payees added; the "Modified" component lists changes to existing payee information; and the "New & Modified" component lists the payees on the "New" and "Modified" components. LOL was to use the LR-095 report daily to monitor the creation of new payees or changes to existing payee information in LASR by local office staff. However, we noted that not all components of the report would be a reliable tool to monitor payee changes. For the same two-day sample period as the e-mail alerts, we noted

that the LR-095 "Modified" component listed only 2 (2%) of 129 changes reported on the other LR-095 report components. For the same one-day sample period as the e-mail alerts, we noted that the LR-095 "Modified" component listed 160 (96%) of 167 changes reported on the other LR-095 report components. However, while this represents a significant increase in the number of changes reported, LOL does not utilize the LR-095 reports but instead relies solely on the e-mail alerts.

RECOMMENDATION

We recommend that the Division develop a process to verify LASR payee information.

AGENCY PRELIMINARY RESPONSE

DHS agrees. DHS informed us that it will require completion of a W-9 for each vendor or supplier entered into the system. DHS indicated that this will allow it to monitor vendor and supplier changes. This will be effective October 1, 2011.

SUPPLEMENTAL INFORMATION

OVERSIGHT OF LOCAL ACCOUNTING SYSTEM
REPLACEMENT (LASR) PAYMENT PROCESSING

Division of Financial Management, Bureau of Accounting,
Department of Human Services (DHS)

Details Regarding Vehicle Purchase Price

Finding 4 a.(3)

1. For the first transaction, the DHS employee/seller sold a 1990 vehicle with 181,000 miles to a client (an apparent family member) on July 28, 2005 for \$1,200. Although a vehicle inspection report dated May 13, 2005 stated that the vehicle was safe and roadworthy, the transaction lacked the required supporting documentation that verified the reasonableness of the purchase price. Based on our review of Department of State records, we determined that the DHS employee/seller purchased this vehicle on May 13, 2005 for \$200 from the same mechanic who prepared the vehicle inspection report used to support the sale to the client.
2. For the second transaction, the DHS employee/seller completed an optional vehicle request form (FIA-249) on September 2, 2005 stating that the purchase price of the 1994 model year vehicle was \$1,200. On the same date, notations in the transaction documentation indicated that a DHS worker called the employee/seller and received confirmation that the purchase price was \$1,200. However, four days later the employee/seller called to change the purchase price to \$700 and returned the \$500 difference to the DHS local office. The transaction lacked documentation to support the reasonableness of either purchase price and also lacked the required vehicle inspection report. Based on our review of Department of State records, we determined that the DHS employee/seller purchased this vehicle in February 2005 for \$100 and mileage of 242,000 miles. The vehicle's mileage at the time of the sale to the client was 252,000 miles.

**OVERSIGHT OF LOCAL ACCOUNTING SYSTEM
REPLACEMENT (LASR) PAYMENT PROCESSING**

Division of Financial Management, Bureau of Accounting,
Department of Human Services (DHS)

Details Regarding Selected LASR Transactions With DHS Employees

As described in Finding 5, we performed risk-based analytical review procedures of LASR transactions and identified 2,535 payments totaling \$426,128 that were made to DHS employees between October 1, 2004 and July 31, 2006.

OVERVIEW:

From these LASR transactions, we selected 110 payments to DHS employees for further review and analysis. We determined that for 52 (47%) of the 110 payments, local office staff either had not processed the payment in compliance with DHS policies and procedures or had not adequately documented reasons for purchases or disposition of the items purchased or the LASR transaction identified an area for improved guidance.

OBSERVATIONS:

- For 16 (28%) of 57 replacement payroll warrant transactions, local office staff processed a replacement payroll warrant before a stop payment had been placed on the original payroll warrant. Two (13%) of the 16 payments resulted in duplicate payments to employees. One employee subsequently reimbursed the duplicate payment and a second employee terminated employment with the State before the local office obtained reimbursement for the duplicate payment totaling \$1,213.
- For 2 (29%) of 7 employee travel transactions, local office staff processed payments that did not comply with DHS procedures for out-of-State travel and reimbursement. Transaction documentation did not always include evidence of required DHS prior approval, the local county board request for the travel, verification that the travel was related to work assignment, adequate reimbursement documentation, and compliance with the DHS travel reimbursement process.

- For 4 (80%) of 5 reimbursement transactions to DHS employees for equipment purchases, local office staff did not document approval of the transaction, the reason for the purchase, or evidence of the final location of the items. Local office staff processing LASR transactions should require and maintain documentation to support that employees paid for and received items for which they are claiming reimbursement. In addition, local office staff should also require support for the location of the purchased items, support for the type of use for the purchased items, and a client signature for program-related purchases for clients. Specifically:
 1. A local office processed a payment to reimburse an employee \$2,303, including sales tax of \$102, for class incentives and supplies for the Youth in Transition Program that the employee purchased and charged on a personal credit card. The supplies and incentives included a \$1,300 notebook computer and a \$500 shopping card. The documentation submitted to support the expenditure did not indicate the disposition of any of the purchased items.
 2. A local office processed a payment to reimburse an employee \$855 for the purchase of a notebook computer and printer for the Youth in Transition Program. Only the employee receiving the payment signed the payment authorization form, and the only support for the transaction was a printout of the on-line order information. The transaction lacked support to document that the employee actually ordered, received, and paid for the computer or the final disposition of the computer.
 3. A local office processed a payment to reimburse an employee \$1,470 for the purchase of a notebook computer, personal digital assistant (PDA), and notebook case for a client attending college. There was no documentation that the client received the purchased items. Also, the documentation indicated that the costs should have been charged to county funds within the Social Welfare Fund but were mistakenly charged to State funding.
 4. A local office processed a payment to reimburse an employee \$662 from county funds within the Social Welfare Fund for two PDAs and screen savers. The reimbursement request indicated that the purchase was for county

administration. Support documentation indicated that one PDA and one screen saver were returned to the store on the same day that the employee received reimbursement. The transaction lacked support that the employee either reimbursed the county \$331 for the cost of the returned PDA and screen saver and sales tax or that the returned items had been replaced.

GLOSSARY

Glossary of Acronyms and Terms

access control	A process by which use of system resources is regulated according to a security policy and is permitted by only authorized entities.
AHP	Administrative Handbook Personnel & Professional Development.
BEM	Bridges Eligibility Manual.
Bridges	Bridges Integrated Automated Eligibility Determination System.
CIMS	Client Information Management System.
Control Objectives for Information and Related Technology (COBIT)	A framework, control objectives, and audit guidelines developed by the IT Governance Institute as a generally applicable and accepted standard for good practices for controls over information technology.
DHS	Department of Human Services.
DHS-84	LASR security access request for local/central office users.
DTMB	Department of Technology, Management & Budget.
effectiveness	Program success in achieving mission and goals.
fiscal review	An on-site review to determine that the local office's accounting records are accurate, fiscal transactions are in compliance with DHS policies and procedures, and its internal control structure is in compliance with Office of Internal Audit requirements.

internal control	The plan, policies, methods, and procedures adopted by management to meet its mission, goals, and objectives. Internal control includes the processes for planning, organizing, directing, and controlling program operations. It includes the systems for measuring, reporting, and monitoring program performance. Internal control serves as a defense in safeguarding assets and in preventing and detecting errors; fraud; violations of laws, regulations, and provisions of contracts and grant agreements; or abuse.
IRS	Internal Revenue Service.
Local Accounting System Replacement (LASR)	A financial accounting system application, developed by the Oracle Corporation, used by DHS local offices Statewide to make payments and maintain books of accounts, clients, vendors and other detail and to produce local and Statewide reports.
LOL	Local Office Liaison Unit.
LR-095 report	new/modified supplier report.
material condition	A reportable condition that could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program.
Michigan Administrative Information Network (MAIN)	The State's automated administrative management system that supports accounting, purchasing, and other financial management activities.
PDA	personal digital assistant.
PEM	Program Eligibility Manual.

performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
privileged access	Extensive system access capabilities granted to individuals responsible for maintaining system resources. This level of access is considered high risk and must be controlled and monitored by management.
reportable condition	A matter that, in the auditor's judgment, represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.
responsibility	In an Oracle environment, a defined user right, similar to privilege. Responsibilities are generally set by the system administrator and specify what transactions a user may perform or what applications a user may access.
system administrator	A user with privileged access who has the capability to assign responsibilities to other users.
user	The person who uses a computer system and its application programs to perform tasks and produce results.

